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U.S. BANKRUPTCY COURT  
MARY A. SULLIVAN, CLERK

UNITED STATES DISTRICT COURT  
DISTRICT OF NEVADA

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In re

Case No. 2:12-cv-00139-MMD-VCF

THE RHODES COMPANIES, LLC aka  
"Rhodes Homes," et al.,

ORDER

Reorganized Debtors.

JAMES M. RHODES,

Appellant,

v.

THE RHODES COMPAINES, LLC aka  
"Rhodes Homes," et al., Reorganized  
Debtors,

Appellee.

**I. SUMMARY**

Before the Court is James M. Rhodes' ("Appellant" or "Rhodes") appeal from the United States Bankruptcy Court for the District of Nevada's January 25, 2012, Order Sustaining Reorganized Debtors' Objection to James Rhodes' Entitlement to the Tax Claim Found in Proof of Claim No. 814-33 ("Order Sustaining Objection"). (See dkt. no. 6.) Based on the reasoning set forth below, the Bankruptcy Court's Order Sustaining Objection is affirmed.

## II. BACKGROUND

### A. Factual History

This case concerns the bankruptcy petition of a group of construction and holding companies, some of which voluntarily commenced this bankruptcy case under chapter 11 of the Bankruptcy Code. On March 31, 2009, each of the debtors (collectively "Debtors") filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Chapter 11 Voluntary Petition, *In re The Rhodes Companies, LLC*, No. 09-14814-LBR (Bankr. D. Nev. Mar. 31, 2009), ECF no. 1. On July 17, 2009, Rhodes filed a Proof of Claim seeking \$10,598,000 for (1) reimbursement for taxes paid by Rhodes on account of taxable income allocated to him from some of the Debtors in the amount of \$9,729,151 (the "Tax Claim") and (2) \$868,849 advanced to Greenway Partners, LLC (the "Greenway Claim"). (See dkt. no. 7 ("Appendix") at 9-30.)

The Tax Claim seeks reimbursement for the taxes Rhodes paid on behalf of Heritage Land Company, LLC, The Rhodes Companies, LLC, and Rhodes Ranch General Partnership (collectively, "the Debtor Entities"). (Appendix at 323, ¶ 1.) The taxable income from the Debtor Entities was passed through to Rhodes through the following Non-Debtors: Sedora Holdings, LLC, Rhodes Ranch, LLC, and Sagebrush Enterprises, Inc. (collectively "the Rhodes Entities" or "Non-Debtor Entities"). (Appendix at 324, ¶ 2.) Rhodes owned and controlled the Non-Debtor Entities, and the Non-Debtor Entities owned and controlled the Debtor Entities; all of them were pass-through entities for federal tax purposes, with their taxable income all allocated to Rhodes.<sup>1</sup> (Appendix at 158, ¶ 14.) The total amount of taxable income that flowed to Rhodes was \$21,014,159. (See Appendix at 12.) Of this amount, \$6,974,159 of taxes and \$2,754,992 in penalties and interest were paid by Rhodes, the sum of which makes up the \$9,729,151 that comprises the Tax Claim. (See Appendix at 12.) The books and records of The Rhodes

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<sup>1</sup>A "pass-through" entity's tax obligation flows through the entities to its members or shareholders. In this case, the Debtor Entities' tax obligations flowed through to Rhodes.

1 Companies, LLC contain a ledger entry dated March 31, 2009, in the amount of  
2 \$9,729,151 due to Rhodes. (Appendix at 323, ¶ 3.) This ledger entry forms the basis for  
3 the Tax Claim.

4 According to Rhodes, the Debtor Entities made distributions to the Non-Debtor  
5 Entities since 2005 and prior to the date of the bankruptcy petition to cover their tax  
6 liabilities. He represents by his declaration testimony that he declared a dividend from  
7 the Debtor Entities to himself as reimbursement for the tax payments. (See Appendix at  
8 155, ¶ 7.)

9 **B. Procedural History**

10 Rhodes argued during bankruptcy, and now on appeal, that a course of conduct  
11 existed prior to the petition's filing that requires the Debtor Entities to reimburse him as a  
12 creditor. The Bankruptcy Court issued the Order Sustaining Objection on November 16,  
13 2010, disallowing and expunging the Tax Claim (see Appendix at 530-33), for the  
14 reasons set out on the record at a hearing held on November 4, 2010 (see Appendix at  
15 498-529). Bankruptcy Judge Linda B. Riegler ruled that Rhodes was under an obligation  
16 to pay the tax liabilities of the Debtor Entities, and the operating documents of the Debtor  
17 Entities do not mandate that they reimburse Rhodes for these obligations. (Appendix at  
18 522.) As a result, Rhodes' Tax Claim is valid only if he demonstrates that a decision was  
19 made by the Debtor Entities to reimburse Rhodes for the tax payments. (Appendix at  
20 522.) Judge Riegler held that such a showing was not made, and, in the alternative, held  
21 that Rhodes' argument about a course of conduct does not apply here due to changed  
22 circumstances brought upon by "hard times." (Appendix at 522.)

23 After denying a motion to reconsider the November 16, 2010, Order (see  
24 Appendix at 878-81), the Bankruptcy Court approved the parties' stipulation that  
25 provided Rhodes the right to appeal the dismissal of his Tax Claim (see Appendix at 905  
26 and 943-45). On January 25, 2012, Rhodes filed his notice of appeal of the Order  
27 Sustaining Objection. See Notice of Appeal, *In re The Rhodes Companies, LLC*, No. 09-

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1 14814-LBR, ECF no. 1637. The question on appeal is whether the Bankruptcy Court  
2 correctly sustained Reorganized Debtors' objection to Rhodes' Tax Claim.

3 **III. STANDARD OF REVIEW**

4 The Bankruptcy Court's conclusions of law are reviewed de novo, and its factual  
5 findings are reviewed for clear error. See *Blausey v. U.S. Tr.*, 552 F.3d 1124, 1132 (9th  
6 Cir. 2009). The Ninth Circuit applies the same standard of review to the Bankruptcy  
7 Court's rulings as the district court does and affords no deference to the district court's  
8 appellate rulings. See *In re AFI Holding, Inc.*, 525 F.3d 700, 702 (9th Cir. 2008).

9 **IV. DISCUSSION**

10 This appeal concerns two primary issues: whether the Debtor Entities declared a  
11 valid distribution to Rhodes prior to their insolvency, and whether the course of conduct  
12 between the Debtor Entities and Rhodes established the existence of an implied contract  
13 to warrant equitably sustaining Rhodes' Tax Claim.

14 **A. Valid Distribution**

15 Rhodes first argues that the Bankruptcy Court erred when it determined that the  
16 declaration of the distribution to Rhodes did not create an enforceable obligation on the  
17 Debtor Entities. Rhodes represents that he declared a dividend from each of the Debtor  
18 Entities to Sagebrush Enterprises ("Sagebrush") for reimbursement of the taxes he paid,  
19 but does not give an indication as to when that declaration occurred. (See Appendix at  
20 155, ¶ 7.) Sagebrush is the lone member of The Rhodes Companies, LLC and owned  
21 exclusively by Rhodes as his "primary operating entity." (Appendix at 157, ¶ 12.)  
22 Rhodes states that the Debtor Entities' declaration was to Sagebrush, not himself  
23 individually. The records of the Rhodes Companies, LLC show a ledger entry dated  
24 March 31, 2009, the date of the Debtor Entities' bankruptcy filing, in the amount of the  
25 Tax Claim due to Rhodes. (See Appendix at 324, ¶ 3). Rhodes suggests the timing of  
26 the dividend's ledger entry is irrelevant, since the obligation to make the distribution to  
27 Rhodes existed as soon as it was declared, not at the time it appeared on the books.

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1 In order to unpack this argument, the Court first notes that whether the distribution  
2 occurred is a question of fact entitled to deference under a clearly erroneous standard,  
3 but whether the evidence in the record is sufficient to establish a decision to declare a  
4 dividend is a legal question. The parties dispute both. Rhodes argues that a dividend  
5 declaration is sufficient without any kind of formal process, and can be enforced based  
6 upon past practice. He also argues that the Bankruptcy Court improperly disregarded  
7 his sworn statement that a dividend was declared prior to the bankruptcy filing, which he  
8 contends provide sufficient factual basis to conclude a declaration actually occurred. On  
9 the other hand, Reorganized Debtors argue that a dividend declaration requires more  
10 than an unwritten, unspoken statement of intent in order to be enforceable as a matter of  
11 law. They also attack the unreliability of Rhodes' sworn statement, arguing that it is  
12 insufficient proof to conclude that a dividend was actually declared.

13 **1. Legal Requirement for an Enforceable Declaration**

14 The Bankruptcy Court based her rejection of Rhodes' Tax Claim in part on the  
15 lack of evidence to demonstrate a decision was made regarding a declaration, noting  
16 that a dividend declaration requires some formalities or process in order to be  
17 enforceable. (See Appendix at 513 and 522.) This conclusion was correct. The parties  
18 do not doubt that a valid declaration of a dividend vests at the time of the declaration,  
19 thereby instantly entitling the dividend recipient to the claimed amount. See, e.g., *United*  
20 *States v. Sw. Portland Cement Co.*, 97 F.2d 413, 415 (9th Cir. 1938) ("The general rule  
21 is that a complete and valid declaration of a dividend operates to create a debtor-creditor  
22 relationship between a corporation and its stockholders and that once a dividend is fully  
23 declared and public announcement has been made of that fact, a board of directors is  
24 powerless to rescind or revoke its action, the reason being that a 'debtor' cannot rescind

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1 its debt").<sup>2</sup> "A declaration of dividend which does not create a definite, irrevocable and  
2 enforceable debt against the corporation in favor of the stockholders is not a fully  
3 declared dividend." *United States v. Baldy*, 108 F.2d 591 (9th Cir. 1939); *Sw. Portland*  
4 *Cement Co.*, 97 F.2d at 415 (holding that a declaration qualified by the phrase "until  
5 otherwise ordered by the Board of Directors" was not an irrevocable declaration of a  
6 dividend). A certain level of specificity in form is thus required: a declaration must  
7 express a definite and final intent to pay a dividend; the dividend must be specific; and  
8 its payment must be scheduled on a fixed date. See 11 WILLIAM M. FLETCHER, FLETCHER  
9 CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5323 (2012) ("Courts have held that an  
10 irrevocable declaration has not been created by the directors when it does not express a  
11 definite and final intent to pay a specified dividend on a fixed date."). Rhodes' statement  
12 does not demonstrate that these formalities were met, as it does not indicate when the  
13 declaration was made or when the dividend was to be paid. Indeed, Rhodes only states  
14 that he declared a dividend from each Debtor Entity to Sagebrush Enterprises, Inc. (a  
15 Non-Debtor Entity), and not a dividend to himself.<sup>3</sup> Even assuming as true his statement  
16 concerning the dividend declaration, the Court cannot conclude that the declaration  
17 made was procedurally sufficient to be enforceable during bankruptcy.

18 These procedural requirements are not to be confused with what corporate law  
19 commonly refers to as the formalities of a corporate form, as in meeting minutes or a  
20 formal vote of a board of directors. In that sense, Rhodes is correct in his citation to the  
21 general principle that a division of corporate profits without the formalities of a

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23 <sup>2</sup>Although this case involves the dealings of limited liability companies and one  
24 general partnership, the Court cites to established principles of corporate law in its  
25 reasoning. At various locations in their briefs, the parties both advance and disown the  
26 use of corporate law. Nevada's law governing limited liability companies and general  
27 partnerships do not appear to speak to the issues before the Court, and the Court's  
28 ultimate holding affirming the Bankruptcy Court's order does not depend on this choice  
of law.

<sup>3</sup>In his Opening Brief, Rhodes cites his sworn statement and states that he  
declared a dividend from the Debtor Entities to himself. (See dkt. no. 6 ("Opening Br.")  
at 11, ¶ 17.) However, the section of his sworn statement that the Brief relies upon only  
states that the dividend was declared to Sagebrush. (Appendix at 155, ¶ 7.)

1 declaration is proper, particularly for closed corporations. But formalities in this context  
2 refer to meetings, stockholder reports, votes, and minutes, such that "a distribution to  
3 shareholders may amount to a legal dividend without the formal vote and resolution of  
4 directors." See 11 WILLIAM M. FLETCHER, *supra*, FLETCHER CYCLOPEDIA OF THE LAW OF  
5 CORPORATIONS § 5350. However, a declaration must nevertheless comport with the  
6 procedural requirements recognized in *Baldy* and *Sw. Portland Cement* to be considered  
7 irrevocable and enforceable. Accordingly, the Bankruptcy Court correctly ruled that the  
8 facts attested to by Rhodes do not support a legal determination that an enforceable  
9 dividend was declared.

## 10 2. Evidentiary Basis for Finding a Valid Declaration

11 Even if merely declaring an open-ended dividend was sufficient to create a valid  
12 and irrevocable dividend, it was not error for the Bankruptcy Court to find that Rhodes  
13 did not prove the existence of a valid declaration. The lack of evidence beyond his  
14 sworn statement coupled with the ledger entry recorded at the time of the petition filing  
15 are the only data points offered by Rhodes to prove the existence of a dividend  
16 declaration.<sup>4</sup> This evidence is not enough to meet his ultimate burden of proof. Rhodes  
17 does not provide the Court with any assurance that the dividend declaration actually  
18 occurred, as no contextual evidence exists to corroborate Rhodes' statement. Further,

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20 <sup>4</sup>The parties dispute the proper allocation of the burden of proof on the issue. A  
21 proof of claim is deemed allowed unless a party in interest objects under 11 U.S.C. §  
22 502(a) and constitutes "*prima facie* evidence of the validity and amount of the claim"  
23 pursuant to Bankruptcy Rule 3001(f). See also Fed. R. Bankr. P. 3007. "The filing of an  
24 objection to a proof of claim 'creates a dispute which is a contested matter' within the  
25 meaning of Bankruptcy Rule 9014 and must be resolved after notice and opportunity for  
26 hearing upon a motion for relief." *Lundell v. Anchor Const. Specialists, Inc.*, 223 F.3d  
27 1035, 1039 (9th Cir. 2000) (*quoting* Fed. R. Bankr. P. 9014 advisory committee notes).  
28 "An objector must come forward with sufficient evidence and 'show facts tending to  
defeat the claim by probative force equal to that of the allegations of the proofs of claim  
themselves.'" *Lundell*, 223 F.3d at 1039 (*quoting Wright v. Holm*, 931 F.2d 620, 623 (9th  
Cir. 1991)). If the objector raises evidence which, if believed, would refute at least one of  
the allegations essential to a claim, the burden shifts to the claimant to prove by a  
preponderance of the evidence the validity of the claim. *Id.* (noting that the ultimate  
proof of persuasion is "at all times" upon the claimant). Here, the burden of proof is upon  
Rhodes to establish the validity of his Tax Claim, as Reorganized Debtors properly  
rebutted the presumption of validity by attacking the sufficiency of the evidence in  
support of Rhodes' Tax Claim.



1 the ledger entry raises serious questions as to the purported declaration's validity.  
2 Without supporting documentation or facts, the Court is left to conclude that the ledger  
3 note was recorded as an attempt to circumvent reorganization and withhold funds from  
4 future creditors. Accordingly, the Bankruptcy Court's factual and legal rulings as to the  
5 validity of the dividend declaration are affirmed.

6 **B. Period of Solvency**

7 Even assuming the validity of the declaration and distribution, the Bankruptcy  
8 Court's factual determination that the Debtor Entities were likely insolvent at the time of  
9 the purported distribution itself invalidates Rhodes' Tax Claim.

10 It is well established that a company may not authorize a distribution at a time in  
11 which the company is insolvent. See, e.g., NRS § 86.343 (governing limited liability  
12 companies). The Bankruptcy Court determined that the timing of the ledger entry, and  
13 the lack of evidence demonstrating an earlier declaration of a dividend, suggest that any  
14 purported declaration was issued while the Debtor Entities were insolvent. The  
15 Bankruptcy Court noted that the Debtor Entities might have been insolvent at the time  
16 the dividend was declared. (See Appendix at 861-62.) In his affidavit filed on the petition  
17 date in the related case *In re Heritage Land Company, LLC*, et al. No. 09-04778 (B. D.  
18 Nev. filed April 1, 2009), ECF No. 34 at ¶ 26, Rhodes informed the Bankruptcy Court that  
19 the Debtor Entities were unable to pay their obligations as early as March 31, 2008, a  
20 year before the ledger entry was entered. Having failed to demonstrate when the Debtor  
21 Entities declared the dividend, significant doubt exists as to whether the Debtor Entities  
22 were solvent at the time in which they declared the dividend to Rhodes.<sup>5</sup> As a result, the  
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24 <sup>5</sup>The Court again notes that the burden of proof rests solely on Rhodes, not, as he  
25 argues, on Reorganized Debtors. Rhodes makes much of the fact that Reorganized  
26 Debtors have failed to prove when the declaration occurred, arguing that their inability to  
27 cut through Rhodes' opaque testimony somehow renders their objection invalid. But as  
28 discussed above, Rhodes carries the ultimate burden of persuasion: he cannot create  
confusion surrounding a questionable dividend declaration that he fails to provide  
support for, then subsequently point fingers at Reorganized Debtors for revealing this  
lack of clarity.



1 Bankruptcy Court rested its decision upholding Reorganized Debtors' objection at least  
2 in part on the question of insolvency. This ruling was not in error.

3 **C. Course of Conduct and Implied Contract**

4 Rhodes also argues that the Bankruptcy Code erred when it determined that the  
5 course of conduct between Rhodes and the Debtor Entities did not establish the  
6 existence of a contract. He argues that the course of conduct between Rhodes and the  
7 Debtor Entities evidences an implied contract between the parties to reimburse Rhodes  
8 for his tax payments.

9 Reorganized Debtors lodge a procedural objection to this argument, which the  
10 Court dismisses at the outset. Reorganized Debtors assert that Rhodes' implied  
11 contract argument is waived, since he failed to raise the issue during the bankruptcy  
12 proceedings. But this was only a defect in form, not in function. Rhodes consistently  
13 argued that the course of conduct between himself and the Debtor Entities validates his  
14 Tax Claim. Although he did not appear to utter the words "implied contract" as such, the  
15 Court is satisfied that his course of conduct argument sufficiently preserved this issue for  
16 appeal, since it is well established that prior course of conduct can demonstrate mutual  
17 assent to promises and consideration sufficient to establish an implied contract. See  
18 *Smith v. Recrion Corp.*, 541 P.2d 663, 664 (Nev. 1975) ("The terms of an express  
19 contract are stated in words while those of an implied contract are manifested by  
20 conduct."); *Warrington v. Empey*, 590 P.2d 1162, 1163 (Nev. 1979) ("In an implied  
21 contract, [manifestation of intent to contract] is inferred from the conduct of the parties  
22 and other relevant facts and circumstances.").

23 Turning to its merits, the position that Rhodes and the Debtor Entities entered into  
24 an implied contract is without merit. First, no consideration existed for the Debtor  
25 Entities' promise to repay Rhodes for the tax payments, since Rhodes was under a legal  
26 obligation to pay for the tax liabilities of his pass-through entities. See *Cnty. of Clark v.*  
27 *Bonanza No. 1*, 615 P.2d 939, 944 (Nev. 1980) ("Consideration is not adequate when it  
28 is a mere promise to perform that which the promisor is already bound to do."). The

1 Bankruptcy Court correctly ruled that Rhodes was obligated by law to pay taxes, and  
2 therefore could not use that obligation as consideration, even in return for maintaining  
3 his position as director and CEO of the Debtor Entities as he argues in his Reply. (See  
4 dkt. no. 10 at 10:4-5.) Second, no evidence exists demonstrating a manifestation of  
5 intent to enter into a contract. Nothing beyond Rhodes' sworn statement supports such  
6 a finding; no documents supporting prior distributions were produced, nor do any  
7 expressions of intent exist. Lastly, even assuming such an intent existed, circumstances  
8 changed between when the alleged pattern of conduct occurred and the instant dividend  
9 declaration so as to invalidate any mutual assent between the parties. As the  
10 Bankruptcy Court correctly pointed out, an impending insolvency is a sufficient change of  
11 circumstances to vitiate whatever implied contract existed between the parties, since the  
12 assumptions material to any agreement would have changed in the intervening time.  
13 See *Warrington v. Empey*, 95 590 P.2d 1162, 1163 (1979) ("In an implied contract, [an  
14 intent to contract] is inferred from the conduct of the parties and other relevant facts and  
15 circumstances."). The facts of looming insolvency and difficult economic times constitute  
16 just the sort of relevant circumstances that disfavor an inference of mutual assent based  
17 on past conduct. The Court therefore affirms the Bankruptcy Court's decision to  
18 disregard Rhodes' course of conduct argument.

19 **V. CONCLUSION**

20 After reviewing the record and the parties' briefs, the Court concludes that  
21 Rhodes has failed to demonstrate that the Bankruptcy Court's findings of fact were  
22 clearly erroneous or that its legal conclusions were in error. Accordingly, IT IS HEREBY  
23 ORDERED that the decision of the Bankruptcy Court is AFFIRMED.

24 DATED THIS 29<sup>th</sup> day of May 2013.

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MIRANDA M. DU  
UNITED STATES DISTRICT JUDGE